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Economic Regulation in a Plural Public Sector; The Office of Rail and Road and Network Rail.

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What is the justification for economic regulation of publicly-owned enterprises by an independent agency? The conventional argument is that this is to prevent unfair competition, especially where a public enterprise controls essential infrastructure or has a dominant position, but this article will argue that there are other justifications which apply even where there is limited competition in relevant markets. The example chosen will be that of the regulation of Network Rail, the UK owner and operator of rail infrastructure, by the Office of Rail and Road (ORR). The ORR does indeed have a role in promoting fair competition and access to essential infrastructure for enterprises providing rail services, but overall competition within the UK rail market is highly restricted. EU law requires a regulatory body to supervise access to infrastructure, but, quite apart from the (uncertain) effects of Brexit, the role of the ORR goes far beyond this and, as we shall see, encompasses major tasks not shared by its counterparts elsewhere in Europe. Why then is a regulatory agency needed? Could its tasks be better performed directly by government?

In 2001 I suggested in this journal that there was a place for independent economic regulation of state-owned enterprises, in particular to secure a greater degree of transparency compared to the highly secretive and incoherent relations between government and nationalised industries characteristic of earlier practice in the UK.¹ This argument needs revisiting in the context of highly complex institutional relationships now characteristic both of government and of public enterprises themselves. A further justification for independent regulatory agencies has been that of promoting competition, especially in markets liberalised under EU law, notably electronic communications and energy (though most UK regulatory developments predate this). The argument is that the promotion of effective competition requires regulatory independence both from market actors and government, especially where,

* I am most grateful to Akis Psygkas, Charlotte Villiers and the anonymous reviewer for very helpful comments.

¹ T. Prosser, 'Regulating Public Enterprises' [2001] P.L. 505. For earlier experience with the nationalised industries see Prosser, *Nationalised Industries and Public Control* (Oxford: Blackwell, 1986).

as in several Continental European countries, government has retained a substantial stake in dominant enterprises.²

This article will suggest a different justification for independent, *ex ante*, regulation of public enterprises; that of coping with institutional complexity. As the argument will show, both government and public enterprises now involve a high degree of institutional pluralism, and some of the most serious problems which have arisen result from a lack of communication between the various actors. This results in a 'regulatory space' very different from that of bilateral relationships between enterprise and an assumed unitary government.³ Independent regulation has two especial advantages in relation to such a multi-actor system. As we shall see, it can provide a means of creating fora for the critical and collaborative exchange of information and requirements between the different actors. Secondly, such regulation can provide an independent source of scrutiny both of the information itself and the adequacy of the communicative arrangements between the different actors.

I shall concentrate on one area of rail regulation; that of funding rail infrastructure and the role of the ORR in this. The governing institutions involved include not just the ORR itself but the Department for Transport as the relevant department of central government, the devolved governments of the different nations of the UK, emerging new institutions at regional level, and local government. The Scottish Government has broad responsibility for rail policy and strategy, including both franchising of passenger services and funding infrastructure improvements. The Welsh Government has also had increased responsibilities devolved to it, including substantial powers on franchising and also in relation to infrastructure on some routes in Wales. Management of two rail franchises in the North of England has been delegated to Rail North, a consortium of local authorities, acting in partnership with the Department for Transport, and a similar model has been adopted for the West Midlands through the role of the West Midlands Combined Authority. In addition to their role in franchising, it is also intended that regional bodies will have a greater role in planning enhancements of the rail network, including funding.

² See S. Lavrijssen and A. Ottow, 'Independent Supervisory Authorities: A Fragile Concept' (2012) 39 *Legal Issues of European Integration*, 419; case C-424/07, *Commission v Federal Republic of Germany*, [2010] ECR I-01885.

³ For the origins of the influential concept of 'regulatory space' see L. Hancher and M. Moran, 'Organising Regulatory Space' in Hancher and Moran (eds), *Capitalism, Culture and Economic Regulation* (Oxford: Clarendon Press, 1989), 271-99.

The delivery of rail services is through a peculiarly complex set of different actors in the UK. Network Rail itself (now increasingly internally devolved to regions and routes) owns and operates the infrastructure and since 2014 has been in the public sector. Users in the form of private passenger train operating companies and the providers of freight services need to gain access to the infrastructure in order to run services, and they pay charges for such access. Network Rail also has massive funding from central government in the form of direct grants and borrowing. I shall argue that, within this complicated picture, the role of the regulator should be to organise and enhance communication between these various actors and to ‘keep them honest’ by providing outside scrutiny, especially *ex ante* scrutiny, of their operations.

The future of rail services is a matter of intense public debate in the UK, with the current government having announced a major review and the main opposition party pledged to renationalisation. Whatever the outcome, whether it involves altered arrangements for private delivery of services or extended public ownership, a complex and pluralistic institutional pattern is set to remain. There is likely to be a growing role for sub-national government, devolution has taken place within Network Rail itself, and even if renationalisation of the delivery of services takes place, it is not likely to take a highly centralised form.⁴

The Office of Rail and Road

The ORR was created as the Office of the Rail Regulator by the Railways Act 1993, and initially followed the model of vesting legal powers in a single director assisted by an office. However, this structure was replaced under the Railways and Transport Safety Act by a regulatory commission similar to that developed for other public utilities. It is composed of a Chairman and Chief Executive, two other executive members and seven non-executive directors. Under the Railways Act 2005 the ORR acquired responsibility for rail safety and has more recently also acquired some responsibilities for economic management of the roads network; both fall outside the scope of this article. It is funded entirely by licence fees and a levy for its safety work.

The ORR’s functions are set out in the Railways Act (as heavily amended).⁵ The major functions are to regulate Network Rail’s management of the national rail network, including

⁴ For suggestions as to the future see e.g. T.Prosser and L.Butler, ‘Rail Franchises, Competition and Public Service’ (2018) 81 M.L.R. 23.

⁵ See e.g. ss. 67, 69.

determining its output targets and funding requirements, to licence operators of railway assets, and to approve track, station and light maintenance depot access.⁶ Underlying these functions are complex statutory duties applying to the ORR; indeed, given the complexity and incoherence of these duties they are clearly due for clarification and reform.⁷ They include duties to promote improvements in railway service performance, to protect the interests of rail users, to promote the use of the rail network to the greatest extent that the ORR considers reasonably practicable, to contribute to the development of an integrated system of transport and to sustainable development, to promote efficiency and economy by providers of rail services, to promote competition and to impose the minimum restrictions on rail operators consistent with the operation of the ORR's functions. Given the complexity and the contradictory nature of the duties, the ORR has to develop objectives through its business plan and prioritise the use of its resources accordingly.⁸

In rail liberalisation elsewhere in the EU, the role of the regulator is to promote competition by policing charges to avoid discrimination and securing access by competing operators to essential facilities.⁹ However, the model of rail privatisation adopted in the UK has only a very limited role for on-track competition for passenger services through 'open access' competition. This represents less than 1% passenger miles, and recent proposals to increase its role substantially are unlikely to result in fundamental change.¹⁰ Instead, a system of franchising was adopted in which the competition is for the award of a franchise giving near-exclusive rights for the provision of services over particular groups of routes; competition is for the franchise, not on the tracks.¹¹ Rail freight by contrast has been liberalised with competing operators providing services on the tracks. The ORR does have competition-promoting functions in approving access arrangements, for example to stations and maintenance depots, and it has powers to enforce competition law in the rail sector concurrently with the Competition and Markets Authority.¹² Of all the ORR functions,

⁶ For a useful summary see ORR, 'Our Functions' at <http://orr.gov.uk/about-orr/what-we-do/our-functions> (accessed 16 May 2019).

⁷ The duties are set out in s. 4 of the Railways Act 1993, as heavily amended.

⁸ For the current version see *Office of Rail and Road Business Plan 2018-19* at: http://orr.gov.uk/data/assets/pdf_file/0006/27465/orr-business-plan-2018-19.pdf (accessed 16 May 2019).

⁹ See in particular the recast directive; *Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area*, JO L 343/32, 14.12.2012.

¹⁰ Competition and Markets Authority, *Competition in Passenger Rail Transport Services in Great Britain: A Policy Document* (London: Competition and Markets Authority 2016). For the lukewarm response by the Government see Department for Transport, *Connecting People: A Strategic Vision for Rail*, Cm 9519, (2017), para. 3.43.

¹¹ For a detailed discussion see Prosser and Butler, *op. cit.*, n. 4.

¹² Railways Act 1993 as amended, s. 67.

however, the Periodic Review process is of the greatest importance, much more so than the promotion of on-track competition for passenger services. This is conducted every five years and requires the ORR to determine what Network Rail is to deliver over the next five years and how this should be funded; it will be considered in depth in the following section.

Although the ORR is an independent regulatory agency not subject to direct government control of its decisions, it operates in a field inevitably central to government transport policy and its decisions may have major implications for public spending. In 2017-18 the rail system received net government support of £6.4 billion, £4 billion of which took the form of direct grants to the infrastructure company. Network Rail had debt of £51.2 billion, which is covered by a government guarantee.¹³ Clearly then, Network Rail efficiency will be something which is of central concern to government and to taxpayers. This is in part recognised in the legislative framework; the Act requires the ORR to have regard to general guidance given by the Secretary of State.¹⁴ It has been regularly reissued, the most recent edition being from July 2017, but is brief and highly general, setting out high-level objectives such as valuing passengers as customers, reforming the railway, securing value for money and fostering investment.¹⁵

A major tension throughout the life of the ORR has been how to maintain independence whilst recognising the constraints imposed by this broader framework. There was an early crisis in relations. Network Rail's predecessor was the wholly privatised Railtrack, which faced financial collapse after neglect of infrastructure investment and maintenance resulting in a number of accidents. Railtrack then approached the government for further funds and for the company to be taken out of the regulatory regime for four years; it was also possible that the regulator would be prepared to come to the company's aid by agreeing an interim review of charges to ease its finances. However, the Government proceeded by placing Railtrack into administration under the Railways Act, therefore effectively ending its existence. The Rail Regulator was told that, should he initiate an interim review of charges, the government would rush through emergency legislation to remove his powers to do so. This represented

¹³ ORR, *Rail Finance: 2017-18 Annual Statistical Release* at: http://orr.gov.uk/_data/assets/pdf_file/0006/39381/rail-finance-statistical-release-2017-18.pdf (accessed 16 May 2019).

¹⁴ Railways Act 1993, as amended, ss 4(5)(a) and 4(5B).

¹⁵ Department for Transport, *Guidance to the Office of Rail and Road* (2017) at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/629698/guidance-to-the-office-of-rail-and-road.pdf (accessed 16 May 2019).

an unprecedented attempt to overrule a regulator in the exercise of its allocated responsibilities.¹⁶

A new, much more satisfactory, system was established by the Railways Act 2005.¹⁷ Before each periodic review of charges the Secretary of State must set out the government's strategy ('information about what he wants to be achieved by railway activities in Great Britain') and the public resources available to for the railways during the period covered by the periodic review.¹⁸ They take the form of the 'high level output specification' (HLOS) and the 'statement of public funds available' (SOFA); similar statements are issued by the Scottish Government. These statements serve both to create a meaningful context in which the ORR can review charges, and to enable it to consider whether funding is sufficient for the outputs to be achieved. The system goes a considerable way towards creating a rational and open division of functions between regulator and government, though, as we shall see, the approach of government to the provision of detail in the HLOS has not been consistent.

One further change is of the utmost importance in understanding the role of the ORR in relation to Network Rail. Its predecessor, Railtrack, was a wholly privately-owned company. After Railtrack's demise, Network Rail was created as a statutory corporation in the form of a not-for-dividend private company limited by guarantee. It was composed of over 100 public and industry members reflecting stakeholder interests in rail. Crucially, its borrowings were not on the government's balance sheet; instead it funded investment through massive borrowing from the private sector; its debt stood at £31 billion by 2014. However, from September 2014 it was reclassified as a public body due to the interpretation by the Office for National Statistics of the European accounting standard ESA10; the effect was that its borrowing would be treated in future as government borrowing. The Secretary of State became the sole member of Network Rail, and in future it was to borrow only from the Treasury. Relations between the Department and Network Rail are governed by a Framework agreement.¹⁹ The most important change was that, whilst previously there was no limit to Network Rail borrowing, a hard debt ceiling of £30.3 billion was set to cover expenditure required in the next five year regulatory control period. Freedom to move money

¹⁶ For the then regulator's account of events see T. Winsor, 'The Future of the Railways: Sir Robert Reid Memorial Lecture 2004' (2003/04) 13 *Utilities Law Review*, 145.

¹⁷ Department for Transport, *The Future of Rail*, Cm 6233 (2004); Railways Act 1993 as amended, sch. 4, paras 1-1H.

¹⁸ Railways Act 1993, as amended, sch. 4A, para. 1D.

¹⁹ Department for Transport, *Network Rail Framework Agreement* (2014).

between years and between capital and operational expenditure was also restricted. The effect was seriously to limit future flexibility of investment funding and to make the oversight of its affordability much more important.²⁰ Network Rail is thus a wholly public enterprise, a point often missed in criticism of the ‘privatised’ UK rail network.

The Periodic Review Process

At first sight the Periodic Review may appear to be little different from the regular reviews by other regulatory agencies of the charges of monopoly network industries, thus setting the access costs for other companies which provide services using the infrastructure, and effectively determining a substantial proportion of prices to consumers.²¹ In practice, however, the rail Periodic Review is a process of extraordinary depth and detail.²² It takes the form of a five-yearly review of the access charges which Network Rail can levy on users (including train operating companies); the review also determines the outputs which the enterprise is to deliver, and effectively determines how the framework of public funding described above can be used most efficiently. The Review is forward-looking; it sets the outputs and funding for a five-year Control Period commencing after the review has been completed. It differs from other regulatory reviews in that so much of the funding of the rail network comes from public funds, and it thus involves in-depth scrutiny of the enterprise’s efficiency and goes far beyond the competition-based functions of rail regulators elsewhere in Europe designed to prevent discriminatory charges being levied.

The first Periodic Review in 2000 was highly critical of the financial regime adopted after privatisation, but it was rapidly overtaken by the collapse of Railtrack and the related problems around the role of government mentioned above. The 2008 Review was undertaken under the new regime in the Railways Act 2005 clarifying the role of government, and seems to have been broadly successful, though there was some criticism that it had been a relatively closed process involving the Department for Transport producing a plan handed over as a finished product and that there had been limited accountability to the broader public and to other stakeholders.²³

²⁰ For details see Department for Transport, *Report of the Bowe Review into the planning of Network Rail’s Enhancements Programme 2014-2019*, Cm 9147 (2015), paras 4.20-22, 4.38.

²¹ For an introduction to the issues of network regulation, see R. Baldwin, M. Cave and M. Lodge, *Understanding Regulation: Theory Strategy and Practice* (Oxford: Oxford University Press, 2nd ed. 2012), 443-502.

²² The legislative basis is the Railways Act 1993, s. 4 and sch. 4A, both as amended.

²³ ‘Investing in the Railway’, HC 257, 2014-1, para. 12; ORR, *Independent PR08 Programme Evaluation*, esp. at para. 3.6.8.

PR13

The depth and complexity of the process was evident in PR13, which examined funding for Control Period 5 from 2014-19 (CP5). The Review was undertaken in three stages from May 2011 to April 2014, and involved the issue of no less than 27 different consultations and in total 58 related publications.²⁴ The full determination ran to 959 pages. PR13 coincided with a major programme of government investment in the rail industry through ‘enhancements’; investment in improving the network such as new electrification in addition to maintenance and renewal of existing infrastructure. As a basis for this, a HLOS was produced listing a large number of projects to be funded, and also setting out the aim that the rail industry should reduce its costs by £3.5 billion by 2019. The document also contained the SOFA broken down by year; the total government funds available for the five-year period were to be over £18 billion, with a further £3 billion provided by the Scottish Government.²⁵ PR 13 concluded that there was an overall expenditure requirement for CP5 of £38.3bn, of which £12.8bn represented enhancements.²⁶

Given the huge sums involved, the complexity of the process might seem justified, and the process of PR13 itself was greeted by a ‘broadly positive’ response.²⁷ However, there were serious problems in implementation of investment decisions during CP5. For renewals of the infrastructure, there was a decline in efficiency; by June 2015 renewals were costing 19% more than expected. This resulted in around £3.7bn of work being deferred against a forecast spend of around £14bn.²⁸ The major problems occurred in relation to enhancements. The commitment by government to several key projects had occurred at too early a stage to permit costings when the funding package was agreed by the ORR. This was dealt with by the ‘enhancements cost adjustment mechanism’ involving ORR scrutiny of the final costs as they became available, benchmarking them against a baseline efficient cost. In practice there was no relationship between this and the actual costs incurred by Network Rail, and the result was massive cost overruns; notably, costs of the Great Western electrification programme

²⁴ The details can be found in the documents collected under *Periodic Review 2013* on the ORR website at: <http://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/price-controls/periodic-review-2013> (accessed 16 May 2019). A good account of the background is Transport Committee, ‘Investing in the Railway’, n. 23 above, ch. 3.

²⁵ Department for Transport, *Railways Act 2005 Statement* (2012).

²⁶ ORR, *Periodic Review 2013: Final determination of Network Rail’s outputs and funding for 2014-19*, (2013), Table 2, p. 25. This is the gross expenditure requirement, not limited to direct public funding but including funding through access charges and other sources, so is considerably higher than the amount in the SOFA.

²⁷ ‘Investing in the Railway’, n. 23 above, para. 13.

²⁸ ORR, *Making the Railway More Efficient*, 5 September 2017 at: <http://orr.gov.uk/news-and-media/orr-blog/2017/making-the-railway-more-efficient> (accessed 16 May 2019).

rose by £2.1bn, and there were also major delays and reductions in scope.²⁹ As regards enhancements, the process of regulatory scrutiny thus appeared to have failed. What were the reasons for this? They can be located not in the Periodic Review itself but in the problems of dysfunctional institutional relations during the process.

This became evident from a plethora of reviews of a wide range of aspects of rail investment planning and delivery; one question which arose as a result was whether it was appropriate to have independent regulation of public sector bodies. The Bowe review of the planning of the 2014-2019 enhancement programme concluded that a major problem had been the unclear definition of different organisational responsibilities between the Department, Network Rail and the ORR. As a result, management of relations between the organisations had been characterised by ‘unhelpful informality, with unclear assumptions and a working culture that tried to solve project problems in a localised and on an ad hoc basis without regard to implications across the rail portfolio.’³⁰ On this point, the Bowe Review concluded that the reclassification of Network Rail ‘fundamentally increases the oversight required in assuring the affordability of rail infrastructure investment. At CP5 the ORR’s role, in hindsight, was unclear; and, given reclassification, I conclude that the role of the regulator for future enhancement planning needs to be rethought.’³¹ Despite the opening up to stakeholders of the PR13 process, the report found that there had been only limited involvement of users in the planning and implementation of how enhancements should be delivered; ‘I have been struck, as I have considered all the evidence provided to the Review, by the lack of any clear view about who is responsible for articulating the specific interests of users of the rail system and in particular passengers.’³²

The question of whether independent regulation of Network Rail was still required was also considered in depth in another review, the Shaw Report on the future shape and funding of Network Rail. It strongly supported the continuation of independent regulation, including retention of the Periodic Review process. Independence was required to give the regulator authority, and, although there was a number of areas where tension would arise between the regulator and government, there was still a need for ‘healthy, challenging, and constructive dialogue between Network Rail, the ORR and the DfT. ... Transparency of communication and publication will be an important factor in preventing any possibility that the ORR is

²⁹ For detailed analysis see National Audit Office, ‘Modernising the Great Western Railway’, HC 781, 2016-17.

³⁰ *Report of the Bowe Review*, n. 20 above, para. 4.34; see also paras 1.4, 1.7-8, 4.3, 4.10 and 4.30-4.38.

³¹ *Ibid*, para. 4.38.

³² *Ibid*, para. 5.11; see also paras 2.9, 5.5-5.17, 6.26-6.27.

viewed as lacking in independence.³³ The role of the regulator was to be shaped by two further key groups of recommendations. The first was that, as emphasised in other reports, it was necessary to clarify the role of government, which must produce a long-term strategic vision for the railways, based on the views of all the stakeholders, setting clear, deliverable priorities for the next 30 years and a long-term context for political decisions.³⁴ There should also be greater involvement of stakeholders in planning future enhancements and their delivery. Secondly, and key to the report, was the recommendation that Network Rail operations should be internally devolved; it should be split into a central systems operator and regional routes. Not only would this bring the business's operation closer to rail users, it would also permit route-based comparative regulation, thereby reducing the problems caused by the limited role for direct financial sanctions in relation to public enterprises.³⁵ This major emphasis on devolution ties in, as noted above, with a similar stress on devolution of government responsibilities, with an increased role in rail franchising for the Welsh Government and for emerging regional authorities in, for example, the North and the West Midlands. The Government accepted the recommendations of the Shaw report, and a final internal review by the Department for Transport also found strong support for continued independent regulation of Network Rail and decided that it should be retained, though enhancements could be outside the Periodic Review process.³⁶

To summarise lessons to be drawn from this process, at first sight it might seem to be a classic example of regulatory failure. The process was long, demanding and expensive, and did not in the end provide a realistic assessment of the costs and feasibility of the ambitious enhancements programme. The ORR was criticised for inadequate scrutiny of the plans and of Network Rail's capacity to implement them at efficient cost.³⁷ However, an independent evaluation found that consultation during the Review process itself had broadly worked well and had made a clear difference to the outcome; it recommended changes to reduce the burdens of the consultation process through adopting a more collaborative and informal approach.³⁸ It is in the planning and implementation of how enhancements were to take

³³ Department for Transport, *The Shaw Report: The future shape and financing of Network Rail; the recommendations* (2016), para. R2.78.

³⁴ *Ibid*, para. 1.73.

³⁵ *Ibid*, ch. R2.

³⁶ The actual review is not published, but see Department for Transport, *Rail Regulation: Summary of Call for Evidence Responses*, (2016).

³⁷ Committee of Public Accounts, 'Network Rail's 2014-2019 Investment Programme', HC 473, 2015-16, Conclusion 2.

³⁸ P. Boys, *An Independent Study Into the Office of Rail Regulation's Consultation With Stakeholders During PR13* (ORR, 2014).

place after the Review that the limited user involvement identified in the Bowe report was a serious problem.³⁹ This suggests that the major failures were on the part of the Government and of Network Rail, not in the conduct of PR13.⁴⁰ In particular, the former had produced a ‘wish list’ in its HLOS with inadequate costings and had failed to produce anything resembling a long-term vision for the railways within which the development and enhancement of the system could be properly planned. Moreover, Network Rail had inadequate planning and cost control processes and was unresponsive to users; this was made worse by the structural complexity of the fragmented rail industry. Institutional relationships were incoherent and unclear, which had resulted in communication through unstructured personal relationships which did not look at projects in the round, a problem which had characterised earlier relations between government and nationalised industries.⁴¹

PR18

PR18 covers Control Period 6 (CP6) from 2019-2024; it commenced in May 2016 and a final determination was issued on in October 2018.⁴² It determined an overall expenditure requirement of £50bn for England and Wales (including £10.4bn for enhancements, though these were not assessed in the Review) and £5bn for Scotland, and a revenue requirement for funding under the Review of £36bn, as compared with £27bn for CP5.⁴³ There were major differences from the process used for PR13. The first was that the HLOS for England was a very different document than that for the previous Review. In view of the problems which had arisen then one would have expected enhancements to have been spelled out in greater detail with more attention given to costs; in fact, enhancements were excluded from the HLOS, which instead covers only operations maintenance and renewal, safety, performance and reliability, and demand and capacity. All these were dealt with in two pages of a short document strikingly lacking in detail.⁴⁴ By contrast, the HLOS issued by the Scottish Government was a much more substantial document with thirteen pages of detail.⁴⁵ The

³⁹ *Report of the Bowe Review*, n. 20 above, paras 5.14-5.15

⁴⁰ See Committee of Public Accounts, ‘Modernising the Great Western Railway’, HC 776, 2016-17.

⁴¹ See Prosser, *Nationalised Industries and Public Control*, n. 1 above, chs 2-3.

⁴² ORR, *2018 Periodic Review Final Determination: Overview of Approach and Decisions* and a number of other documents collected under *Periodic Review 2018* on the ORR website at: <http://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/price-controls/periodic-review-2018> (accessed 16 May 2019). Apart from the documents published by the ORR itself, there is a good account of the process in the Transport Committee, ‘Rail Infrastructure Investment’, HC 582, 2017-19.

⁴³ *2018 Periodic Review Final Determination*, n. 48 above, tables 8.1, 8.2. Given the major changes between PR13 and PR18, total figures are not directly comparable.

⁴⁴ Department for Transport, ‘Railways Act 2005 Statement: High Level Output Specification’, HC 296, 2017; Department for Transport, ‘Railways Act 2005 Statement: Statement of Funds Available’, HC 448, 2017.

⁴⁵ Transport Scotland, *The Scottish Ministers’ High Level Output Specification for Control Period 6 (2017)*.

specification for England and Wales was hardly an effective response to various reports arguing that a clearer statement of the government's vision and policies for the railways was a pre-requisite for improved regulation and performance of the industry.

Even after the exclusion of enhancements, the public funding was very substantial, with public funds of £34.7bn made available in the SOFA in the form of Network Grant. In developing new arrangements for monitoring this expenditure, PR18 emphasised much more strongly than previously the need to engage effectively with the various stakeholders involved; these included the train operating companies and freight operators, but also funders, passenger representative groups, local authorities and local enterprise partnerships. As part of the Review, the ORR had consulted on stakeholder engagement in drawing up the Network Rail Strategic Business Plan and identified areas for improvement; it has set out its plans for continuing to monitor and assess the quality of stakeholder engagement throughout CP6.⁴⁶ Such monitoring of Network Rail will be facilitated by the devolution of its functions to route level with a relatively small central System Operator responsible for functions such as timetabling. Routes will have major devolved functions, for example in procuring goods and services, and funding and expenditure will be recorded at route level. This will permit comparative regulation and benchmarking in which the regulator will monitor and report publicly on how well each route is performing against its targets.⁴⁷

Through regulation on a route basis, the ORR was then able to identify arrangements for improved scrutiny of performance and for the creation of fora for communicative debate about the findings. The use of scorecards at route level setting out key performance metrics will be central to the monitoring process. The scorecards 'capture what each route plans to deliver to customers and funders, providing a balanced picture across different aspects of delivery, including on safety, asset condition and train performance. Ideally, they should reflect agreement with each customer on a number of key measures, so that scorecards reflect what is particularly important to them.'⁴⁸ The scorecards are developed collaboratively with users and agreed with funders; they will be reviewed annually and performance against them published quarterly. Monitoring will be undertaken through the fora of Railway Boards to

⁴⁶ 2018 Periodic Review Final Determination, n. 42 above, 31, 48-53; ORR, *How the Office of Rail and Road Will Facilitate Improvements in the Quality of Network Rail's Stakeholder Engagement in CP6* (2019).

⁴⁷ 2018 Periodic Review Final Determination, n. 42 above, 38-31; ORR, *Holding Network Rail to Account* (2019).

⁴⁸ ORR, *2018 Periodic Review Final Determination: Summary of Conclusions for England and Wales* (2018) para. 29.

hold routes to account. These are new bodies ‘to provide an opportunity for collaboration between routes/SO and operators, while also acting as a forum to identify issues and seek resolution.’⁴⁹ In the consultation there had been extensive criticism of existing supervisory arrangements, and as a result major changes were made. The Boards will be chaired by an independent member and will be made up of representatives from the route, operators, the system operator, the passenger representative body and local and national funders. They are to issue a public report after each meeting and produce a published annual plan. The Boards themselves will be monitored annually by the ORR to ensure that they continue to engage effectively with the routes and with stakeholders. In addition, the ORR itself will organise hearings between routes and affected parties.⁵⁰ The ORR will also itself employ a wider range of reputational sanctions give the limited effect of financial sanctions on a non-profit oriented body. Its approach will include the escalation of responses where performance is inadequate, representing a rare regulatory acknowledgment of the ‘responsive regulation’ literature.⁵¹

As the HLOS suggested, enhancements were taken out of the Periodic Review, and they were made subject to a separate process involving a ‘Rail Network Enhancement Pipeline’ involving staged decisions, with each project passing a stage only when it was clear that it had passed a number of tests, for example that there was a robust business case and that the enhancement would meet the needs of users and would achieve good value for taxpayers.⁵² Reflecting greater pluralism in rail governance, more enhancements were to be promoted by bodies other than central government, for example local authorities, Metropolitan Mayors and the private sector. This is intended to include financing, and the Scottish Government already funds a substantial programme of rail enhancement. This new approach has the advantage that it separates out enhancements, which may take many years to plan and implement, from the 5-year timescale of the Periodic Reviews, though it is fair to say that this timing was not a major reason for the problems encountered in PR13. However, it also limits opportunities for outside *ex ante* scrutiny of the processes within the Department by appearing seriously to restrict the role of the ORR. The framework agreement between the Department and

⁴⁹ Ibid, para. 71.

⁵⁰ 2018 Periodic Review Final Determination, n. 42 above, 26-34, 42; ORR, *Consultation on ORR’s Approach to Assessing the Quality of Network Rail’s Stakeholder Engagement in CP6* (2018).

⁵¹ ORR, *Holding Network Rail to Account*, n. 47 above. For the classic account of responsive regulation see I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press, 1992).

⁵² Department for Transport, *Rail Network Enhancements Pipeline: A New Approach for Rail Enhancements* (2018).

Network Rail was now supplemented by a memorandum of understanding on enhancements, which treats the process as a bi-lateral one between the Department and the business.⁵³ This apparent reduction in outside scrutiny was criticised by the Transport Committee of the House of Commons as weakening the role of the ORR.⁵⁴ The Committee was not convinced that the Department had taken the necessary steps to ensure that it had the capacity and capability to undertake its new role, including determining cost efficiency and value for money, and in its response the ORR emphasised its role in monitoring and reporting on the delivery of enhancements, rather than offering the *ex ante* scrutiny offered by the Periodic Review. The limitations of this role were confirmed in a later statement where it was made clear that, in England and Wales, the ORR's role is '[n]ot to monitor the cost efficiency of enhancement projects or take action in relation to specific milestones, which will **not** be regulated outputs'.⁵⁵

Conclusions on the Periodic Review Process

The complexity of the process raises the question of whether the tasks outlined here are appropriate for regulatory involvement at all, and this applies particularly to major investment projects, including, though not limited to, enhancements. There are two other alternatives. The first is to leave the market to determine the allocation of funding. This could reflect possible limitations on the ability of regulators to gain information and their lack of expertise in major infrastructure issues. However, market solutions are not available given that Network Rail now borrows from the Treasury, not from the financial markets. Even when it did borrow privately, that appears to have imposed minimal discipline on its finances and its ability to fund investment. Nor, given the natural monopoly elements characteristic of rail infrastructure, is it responsive through markets to its users. In other network industries with natural monopoly characteristics it has proved necessary to set prices through regulatory review, and this is reinforced by the huge amounts of public money involved in rail.

The second alternative is to replace the Periodic Review process with a bi-lateral contractual relationship with the Department as sponsor; this the new position for enhancements. Recent omens are not good for this approach. One example is that of the construction of Crossrail,

⁵³ Department for Transport, *Memorandum of Understanding between Department for Transport and Network Rail on rail enhancements* (2016).

⁵⁴ 'Rail Infrastructure Investment', n. 42 above, para. 94.

⁵⁵ 'Rail Infrastructure Investment', n. 42 above, para. 110; Transport Committee, 'Rail Infrastructure Investment: Government and Office of Rail and Road Responses to the Committee's Fourth Report', HC 1557, 2017-19, 10-12; ORR, *Enhancements in Control Period 6* (2019), para. 21 (emphasis retained). The ORR will designate milestones and hold Network Rail to account for their delivery in Scotland.

the new trans-London line for which costs were forecast to be £14.8 billion. The infrastructure was not developed by Network Rail and did not fall within the Periodic Review process. It was instead jointly sponsored by Transport for London and the Department for Transport, and funds were determined through the government Spending Review process. The line was due to have opened in December 2018, but as late as August 2018 it was revealed that there would be substantial delays and an increase in costs of between £1.6 and £2 billion.⁵⁶ Relations between the sponsors and the Crossrail Board took place through a Sponsor Board, but a review by KPMG found that a basic problem was lack of communication between Board and sponsors; there was no proper sharing of information and an inadequate use of independent advice.⁵⁷ The 2018 Periodic Review and its recommendations were designed precisely to avoid these problems. I shall return to the effectiveness of bilateral contractual relationships in considering comparative experience below. Given the absence of acceptable alternatives, the question is not whether there should be regulatory involvement, but how it should be done; this was indeed the conclusion on regulation of all three of the reviews after PR13 discussed above.

Turning to PR18 itself, there were major improvements made to reflect the pluralism of rail governance and to avoid the problems experienced in its predecessors. Key to these improvements was the recognition of the importance of a variety of different actors within regulatory space; these include train operating companies and freight operators and also passengers and funders. The new emphasis on benchmarking as a means of comparative regulation is linked to new institutional fora involve a wider range of actors in monitoring. These will themselves be monitored by the ORR, thus constituting a form of meta-regulation in which the regulator oversees the management of processes organised by the enterprise itself.⁵⁸ Such approaches to regulatory process are much more appropriate for the regulation of a multi-actor regulatory space than the more conventional techniques adopted in earlier Periodic Reviews. It is also striking that they are being adopted by the independent

⁵⁶ A detailed account of the governance issues can be found in KPMG, *Independent Review of Crossrail - Governance* (KPMG, 2019) available at <http://content.tfl.gov.uk/governance-redacted.pdf> (accessed 16 May 2019). Useful background is also contained in J. Ford and G. Plimmer, 'Why Crossrail Stalled', *The Financial Times*, 21 December 2018, 13.

⁵⁷ KPMG, *Independent Review of Crossrail - Governance* n. 56 above, 9-10, 15-16, 26, 30, 66-7. See also the Public Accounts Committee, 'Rail Management and Timetabling', HC 1793, 2017-19, para. 16.

⁵⁸ For an introduction to the concept of meta-regulation see Baldwin, Cave and Lodge, *Understanding Regulation*, n. 21 above, 147-57. For extended discussion of the concept of reflexive regulation involving benchmarking, stakeholder participation and a range of different, graduated, regulatory responses see the essays in O. de Schutter and J. Lenoble, eds, *Reflexive Governance: Redefining the Public Interest in a Pluralistic World* (Oxford, Hart Publishing, 2010).

regulatory agency rather than by the Department, suggesting that an agency will have more space to experiment with new techniques than will a government department.

Turning to enhancements (though these now represent a relatively small proportion of total funding), the operation of the new system will be dependent on the development of effective procedures for scrutiny within the Department itself, whilst raising the danger that this process will be less transparent than one involving an outside regulator. The Department has committed itself to transparency through the publication of public statements as projects pass each stage of the enhancements pipeline, but this is clearly subject to far less stakeholder involvement and regulatory scrutiny than is the case for the Periodic Review process.⁵⁹

For the Periodic Review to work effectively and for proper organisation of enhancements, government must adopt a clear long-term vision of how it wishes the rail network to develop; this was a key recommendation of the Bowe and Shaw reports, but little has been done to achieve it. As discussed above, the HLOS is actually much vaguer than its predecessor. The Department did issue a White Paper on the future of the railways in late 2017, but it is based on a model of integration between Network Rail routes and train operating companies through the development of partnerships, the detailed plans for which are vague and which are likely to face major problems in practice.⁶⁰ It has already been overtaken by the Government's setting up of a 'root and branch' review of rail in September 2018 after the collapse of the timetabling process in two regions, intended to report by the end of 2019.⁶¹ By contrast to the UK Government, the Scottish Government has a much more developed and articulated strategy for the development of its rail industry, as evidenced by the much fuller HLOS.

Comparative European Experience

It will be useful to examine experience elsewhere in Europe in the context of the (relatively limited) moves towards liberalisation of rail markets. EU law requires independence of undertakings managing railway infrastructure; decisions on essential access to infrastructure and charging must be the responsibility of bodies or firms not themselves providing services,

⁵⁹ 'Rail Infrastructure Investment: Government and Office of Rail and Road Responses to the Committee's Fourth Report' HC 1557, 2017-19, 6-7.

⁶⁰ *Connecting People; A Strategic Vision for Rail*, n. 10 above.

⁶¹ Department for Transport, *Government announces 'root and branch' review of rail*, 20 September 2018, available at: <https://www.gov.uk/government/news/government-announces-root-and-branch-review-of-rail> (accessed 16 May 2019).

and access to infrastructure must be granted on a non-discriminatory basis.⁶² Member States must also establish a licensing authority for railway undertakings, and an independent regulatory body to hear appeals and undertake some monitoring functions.⁶³ The powers of the regulatory bodies are quite far reaching but are essentially concerned with competition issues, in particular the provision of non-discriminatory access to the Network. The infrastructure manager may be funded by the state and must adopt a business plan and balance its books over a five-year period. EU law does not specify the form of state funding for infrastructure; this may be provided through access charges paid by providers of rail services but funding may be supplemented by direct government grants. Indeed, there are major variations in the ways in which different European Member States have chosen to provide support for infrastructure.⁶⁴ The work of the ORR discussed in this article goes far beyond the requirements for independent regulation in EU law.

The most interesting example from Continental Europe for comparative purposes is that of France, where the future organisation and regulation of the rail network has been highly controversial, and a law was passed in 2018 to establish a ‘new railway pact’.⁶⁵ Here the regulatory body is the Autorité de Régulation des Activités Ferroviaires et Routières (ARAFER). It is predominantly concerned with access rights and the avoidance of discriminatory access conditions, reflecting the requirements of EU law and not going substantially beyond them.⁶⁶

Infrastructure support is determined through bilateral contractual relations with the state, since 2014 in the form of a contract between the government and SNCF Réseau, the infrastructure operator.⁶⁷ Investment in SNCF Réseau is subject to control through normal governmental processes, including the use of a government commissioner, but this has not worked well.⁶⁸ ARAFER does have some powers in this context; it must deliver a non-binding opinion on the draft contract, it produces annual reports on implementation. A multi-year performance contract was signed in April 2017, but the first report on it from

⁶² Recast Directive, n. 9 above, arts 4-7, 13, 27.

⁶³ Recast Directive, n. 9 above, arts 16 and 55.

⁶⁴ See J. T. Schäfer and G. Götz, ‘Public Budget Contributions to the European Rail Sector’, (2018) 16 *Review of Network Economics*, 89.

⁶⁵ Loi no. 2018-515 du 27 juin 2018 pour un nouveau pacte ferroviaire.

⁶⁶ See e.g. *Les missions de l’Arafer*, at: <http://www.arafer.fr/les-missions-de-larafer/> (accessed 16 May 2019).

⁶⁷ The framework is set out in the Loi no 2014-872 du 4 août 2014 portant réforme ferroviaire.

⁶⁸ See SNCF Réseau, *SNCF Réseau Group Financial Report 2018* (201), esp. para. 3.6, available at: <https://www.sncf-reseau.com/fr/documentation/finance/annual-report-2018-sncf-reseau> (accessed 16 May 2019).

ARAFER, issued in May 2018, was already highly critical, finding that the contract had not created adequate targets or incentives for the infrastructure operator and there had been no sanctions for failure to meet objectives set. ARAFER recommended urgent revision of the contract to provide a clearer statement of strategic objectives and priorities for the rail network by the government. This should be accompanied by an in-depth analysis involving outside scrutiny of the performance of the infrastructure operator, precisely what the Periodic Reviews offer in the UK.⁶⁹ A similar conclusion was reached in the Spinetta report, commissioned by the French Prime Minister to consider the future of the rail industry, which provided the basis for the 2018 reforms. This Report recommended that ARAFER be given functions much closer to those of the ORR with extended responsibilities for assessing the efficiency of SNCF Réseau. The role of ARAFER should be reinforced in relation to the economic governance of the infrastructure operator by giving it responsibility, within the framework provided by the contract between the government and the operator, for assessing the costs of the network and determining reasonable productivity targets to be used in assessing its efficiency. This was in order to move beyond the current position in which SNCF Réseau was able to build up unlimited debt and was not subject to any financial discipline.⁷⁰ Investment is of course also subject to scrutiny by the state accounting body, the Cour des Comptes, but this is usually *ex post facto* and so resembles the work of the National Audit Office in the UK rather than that of the ORR. The importance of this example is to show that, in France, a bilateral contractual approach to investment in the rail network appears not to have been successful in placing effective disciplines on the infrastructure operator, and it has been a far less transparent and open process than that of the Periodic Reviews in the UK; the lessons are similar to those which were drawn from the discussion of Crossrail above.

The experience in Continental Europe (and this is not limited to France) is that regulatory agencies have an important role in scrutinising charges of rail infrastructure providers on competition grounds, but do not have a role in examining value for money in state investment. Instead this is determined on a bilateral, contractual basis; the aim of

⁶⁹ ARAFER, Avis no. 2018-035 du 14 mai 2018, esp. para. 37, available at: <http://www.arafer.fr/wp-content/uploads/2018/05/avis-2018-035-du-14-mai-2018-contrat-pluriannuel-de-performance-conclu-entre-letat-et-sncf-reseau-version-publique.pdf> (<https://www.sncf-reseau.com/fr/documentation/finance/annual-report-2018-sncf-reseau>).

⁷⁰ Rapport au Premier Ministre, 15 Février 2018, *L'Avenir du Transport Ferroviaire* (the Spinetta Report), Documentation Française, 2018), 69, available at: https://www.ecologique-solidaire.gouv.fr/sites/default/files/2018.02.15_Rapport-Avenir-du-transport-ferroviaire.pdf (accessed 16 May 2019).

contractualisation is to provide the sort of long-term security offered in the UK by the Periodic Reviews. However, bilateral contracting is in several ways inferior to ORR's approach. It is a much more closed process, and it limits the involvement of parties other than central government; there is also clear evidence in France, both from the regulatory body and the major recent review of rail transport, of difficulties in securing clear objectives, proper efficiency incentives for the infrastructure operator, and proper scrutiny of the operator's performance.

Conclusion

Economic regulation of public enterprises has normally been seen as a means of promoting competition where the enterprise controls access to infrastructure or is dominant. This creates a strong case for independent regulation of the rail infrastructure operator, as is the case in other network industries, but fact the process is complicated in the UK both by the rail industry's heavy reliance on public funds rather than charges to other enterprises and consumers and by the role of other actors including public funders and users of the infrastructure. Independent regulation is not just to facilitate the competitive provision of services, but it performs a role of scrutiny *ex ante* in order to examine the feasibility of plans for investment when they are being developed and to assess the best means of achieving value for money. This supplements scrutiny by institutions such as the National Audit Office which is *ex post facto* and inevitably sporadic.

UK experience suggests that the public sector should be seen as an inter-connected network of different institutions at different levels. It is important to stress that this is not a reason for retaining the current fragmented structure of the UK rail industry, which it is now agreed has given rise to major, and unacceptable, problems.⁷¹ Indeed, the approach taken in PR18 stressing the importance of collaboration between different actors could be seen as an attempt (perhaps doomed) to prop up a failed fragmented rail system. However, it has much greater potential than this. At present it is unclear what the future structure of rail will be; but even should there be renationalisation, this is not likely to take the form of a single monolithic

⁷¹ For an example relating to lack of institutional coordination in timetabling see ORR, *Office of Rail and Road: Independent Inquiry Into the Timetable Disruption in May 2018* (2018), available at: http://orr.gov.uk/_data/assets/pdf_file/0010/39916/inquiry-into-may-2018-timetable-disruption-december-2018-report.pdf (accessed 16 May 2019).

public enterprise, which is anyway a mis-reading of the position pre-privatisation when the nationalised British Rail was never an institutional monolith.⁷²

Any move to re-nationalisation will have to take account of the growing regionalisation of both of governmental structures and of rail operation within the UK. Such regionalisation has for some time been a characteristic of rail systems in Continental Europe; the UK has previously been an exception, but this is now changing. Indeed, some influential proponents of re-nationalisation have emphasised this.⁷³ It is also striking that central government in the UK has failed to develop a clear strategy for rail, despite this being a major recommendation of different reviews, as outlined above. If neither top-down nor market forms of organisation work, this leaves room for a greater involvement of sub-national and user groups to fill the gaps. Indeed, the Scottish Government is already leading the way both in the franchising of passenger services and in enhancements.

If the government side is becoming more pluralistic, the same is true of the management and delivery of projects. Quite apart from any potential role for the private sector, a major reform is that of the devolution of Network Rail to regional routes with an increased degree of autonomy to meet user needs. Indeed, this reflects similar internal devolution to regions and business sectors under British Rail; it is in no way incompatible with re-nationalisation. A great advantage of this institutional arrangement is that it permits benchmarking and comparative regulation, thereby making the regulatory task easier, reducing information asymmetry and permitting publicity to be used as a potential sanction. It also permits the closer involvement of users in the form of passenger and freight operators.

The danger of a more pluralistic system of governance is that of incoherence and lack of coordination. It is precisely this that makes the continuation of independent regulation necessary. This is quite distinct from its importance in promoting competition, should that be adopted as major goal in relation to rail. However, to be effective in this context, regulation needs to be of a particular kind. In order to avoid systemic incoherence it needs to facilitate communication between the different parties involved and to provide scrutiny to ‘keep them honest’ by testing claims and performance and providing a means of learning from them.⁷⁴

⁷² See T. Gourvish, *British Rail 1974-97* (Oxford: Oxford University Press, 2002) esp. ch. 11.

⁷³ See e.g. I. Taylor, ‘Nationalisation – Britain’s Railway under Labour’ (2018) *Rail*, 843 available at: <https://www.railmagazine.com/news/rail-features/exclusive> (accessed 16 May 2019). For Continental European experience see e.g. C.Nash, ‘What does a Best Practice Network Look Like’ in M. Finger and P. Messulam (eds), *Rail Economics, Policy and Regulation in Europe* (Cheltenham: Edward Elgar, 2015), 232.

⁷⁴ For an account of such a principle as a more general basis for institutional design see T. Prosser, ‘Constitutions as Communication’ (2017) 15 *International Journal of Constitutional Law*, 1039. For analysis of

What was clear from the experience with PR13, especially in relation to enhancements, was that regulation cannot be effective without proper input from all the parties involved which is then subject to searching scrutiny by others. This was shown by the lack of effective information from government on the ambitious enhancement plans and their costings and the inadequate project planning and implementation by Network Rail. The removal of enhancements from the Periodic Review process for the future could well be a retrograde step through reducing opportunities for independent scrutiny. In other respects, the process for PR18 was a major improvement through greater encouragement of user involvement and use of benchmarking and a range of escalating sanctions.

What will be most important will be a form of regulatory governance that is not simply a matter of informal closed negotiation and bargaining but which maintains structures and processes for collaboration.⁷⁵ In doing so it should be possible for the regulator to play an important role in building trust through forcing an opening out of the debate and a testing of arguments, even where the regulator does not have the final word. This is likely to be feasible in this context as economic regulation of rail infrastructure is essentially concerned with the deployment of resources and value for money. It does not involve the consideration of a wider range of social values which may raise incommensurable principles to be balanced; universal service is dealt with separately through the franchising system. All the actors are likely to speak the same language, thereby reducing the need for regulatory translation, which Black has characterised as a major problem for communicative regulation.⁷⁶

In the UK, nationalisation and delivery of services by public enterprises is back on the political agenda after an absence of many years. Alongside this is a growing pluralisation of the public sector. The effect is to make a developed role for independent regulation more rather than less important. Rail might be seen as different from other means of delivering public services given its peculiarly fragmented institutional structure in the UK; however, the argument may also be relevant to other public services which have complex institutional structures and where communication between different institutions is necessary even within

a similar role of regulatory agencies implementing European Union law see A. Psygkas, *From the 'Democratic Deficit' to the 'Democratic Surplus': Constructing Administrative Democracy in Europe* (Oxford: Oxford University Press, 2017). The leading account of communicative regulation and its limits is J. Black, *Proceduralizing Regulation, Part I*, (2000) 4 OJLS, 597, and *Part II*, (2001) 5 OJLS 33.

⁷⁵ See 'Constitutions as Communication', n. 74 above, 1043-4

⁷⁶ For this concept see Black, *Proceduralizing Regulation, Part II*, n. 74 above, 46-52.

the public sector. Market liberalisation and competition are not the only ways of making public services more responsive to users; the role of regulation will be to facilitate forms of devolution of such services which combine responsiveness with overall coherence and opportunities for scrutiny.